

VZCZCXRO5669
RR RUEHDA
DE RUEHAK #1272/01 1441306
ZNR UUUUU ZZH
R 241306Z MAY 07
FM AMEMBASSY ANKARA
TO RUEHC/SECSTATE WASHDC 2255
INFO RUEATRS/DEPT OF TREASURY WASHDC
RUEHIT/AMCONSUL ISTANBUL 2752
RUEHDA/AMCONSUL ADANA 1976
RUEHBS/USEU BRUSSELS

UNCLAS SECTION 01 OF 02 ANKARA 001272

SIPDIS

TREASURY FOR INTERNATIONAL AFFAIRS - JROSE

SENSITIVE
SIPDIS

REF: ANKARA 685

E.O. 12958: N/A

TAGS: [EFIN](#) [TU](#)

SUBJECT: IMF Board Approval Amid Local Debate

¶1. (SBU) Summary: The IMF Board's May 18 review of Turkey's stand-by program focused on the risk of fiscal slippage during an election, a risk also identified by many local analysts. Approval of the \$1.1 billion IMF tranche also coincides with a rekindled debate about what form Turkey's future relationship with the IMF should take. Nationalist and "secular" opposition parties have been the most vociferous opponents of the IMF program. But debate about the IMF role is not limited to the opposition -- former Central Bank Governor Serdengecti notes a weakening of the IMF "anchor" but stresses the need for a strong domestic policy anchor following the end of the current stand-by arrangement next year. End Summary.

Fiscal Slippage, Populism

¶2. (SBU) So far, election-year spending has not been significant enough to cause problems with the IMF, as the IMF has firm commitments from the government both to block excess 2007 spending and make up for any shortfall after the fact. Nevertheless, as election-day approaches, there are press reports about populist GOT steps that would cause fiscal slippages. Among the measures reported in the press are: amnesties to 400,000 farmers who reportedly owe YTL 400 million to the State; payments to Imar Bank bond holders that will cost about YTL 1.6 billion to the budget; opening more universities; converting 218,000 temporary workers to permanent employment status; broadening regional investment incentives; supplemental allocations for highway construction; increased health expenditures through usage of private hospitals; and pre-election government wage hikes.

¶3. (SBU) These reports need to be taken with a grain of salt, since reported policies are often not implemented. We understand the government has assured the IMF it will not add \$1.5 billion in highway spending, despite press reports. Nevertheless, the obvious election-year pressures lend the reports some credibility to the concerns of the IMF. Prime Minister Erdogan's call for VAT rate reductions in his May 23 speech to TUSIAD is an obvious concern.

¶4. (SBU) Monthly budget results also raise questions about a possible election-year fiscal loosening. January-April data show an 8.3% increase in spending in real terms. VAT receipts are down 12% from last year's level. Special Consumption tax receipts are also down but non-tax revenues -- mostly profits from state-owned enterprises -- overperformed. Still, the overall deficit and primary surplus seem to be broadly in line with achieving the year-end targets: the January-April primary surplus is 37.8% of the full-year target. Nevertheless, IMF rep calculates a shortfall from the primary surplus target of about 0.3% of GDP for the first four months of the year, i.e. a 1% of GDP shortfall on an annual basis.

Local Debate about Sticking with the IMF

5 (SBU) Despite the political uncertainties, Turkey's finances seem, on their face, stronger than ever. Investor inflows have driven the lira to a level higher than before last spring's sell-off. Debt and reserve ratios are the strongest they have been since before the 2001 crisis, the elections have also rekindled the debate about the necessity of the IMF "anchor." With investors still pouring into Turkey, many Turks wonder why the IMF is still needed.

16. (SBU) The political opposition to AKP is the most vocal anti-IMF voice. The secularist crowds in Ankara, Istanbul, Izmir and Samsun featured signs critical of the AKP government's perceived bowing to the EU, the U.S., and -- equally prominently -- the IMF. Speech-makers at these rallies decry sales of state assets and the IMF-supported privatization program.

17. (SBU) Rahsan Ecevit, the widow of former Prime Minister Bulent Ecevit, recently volunteered a set of economic policy prescriptions as she blessed the election alliance of the leftist CHP and DSP parties. Ecevit called for an end to "submission" to EU and IMF demands, as well as termination of land sales to foreigners and an end to Turkey being "an open market for U.S. and EU agricultural products" (sic). The radicalism of this agenda reveals the economic policy cluelessness of many opposition political figures, as reflected in the courts' and President Sezer's frequent derailment of economic reform measures, especially privatizations.

18. (SBU) For his part, CHP leader Deniz Baykal suggests that the terms of Turkey's EU accession framework need to be renegotiated and that AKP-era privatizations would be questioned if CHP came to

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power. He characterized as "nut money" the \$6.5 billion a Saudi investor paid for control of Turk Telekom. Baykal has stressed the need to emphasize local "production" and the "real economy" rather than "demand." This emphasis on local production, echoed by the center-right DYP's economic policy expert, has long been a theme of statist Turkish economic thinking.

Even Reformers are Debating the post-IMF Program Environment

19. (SBU) Readiness to discuss a lessened IMF role is not confined to the opposition. Even economic reformers are talking about it, although they frame the debate differently. Former Central Bank Governor Surreyya Serdengeçti, a supporter of the IMF program, said he believes the IMF anchor had weakened. He said Turkey needed to develop its own "anchor" if the IMF anchor is to be reduced in importance. Similarly, Garanti Bank CEO Ergun Ozgen recently talked about the need for a strong IMF surveillance program if the IMF will no longer be in a lending role once the current Standby Arrangement runs its course. That people like Serdengeçti and Ozgen are discussing these issues, combined with market bullishness and Turkey's reduced vulnerabilities, suggest that even a single-party AKP government might consider moving to a reduced IMF role even before the existing program ends in spring 2008. With Turkey's traditional dislike of foreign-imposed constraints, if the next government thinks it can reduce the IMF's role without being punished by markets, it is likely to do so.

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